

Office of the Legislative Auditor

Montana



Report to the Legislature

September 1992

Financial Audit

Fiscal Year Ended June 30, 1992

Guaranteed Student Loan Program

Commissioner of Higher Education

We issued an unqualified opinion on the financial statements of the program and our report contains no recommendations.

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The Single Audit Act of 1984 and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports regarding the state's federal financial assistance programs, including all findings of noncompliance and questioned costs. This individual agency audit report is not intended to comply with the Single Audit Act of 1984 or OMB Circular A-128 and is therefore not intended for distribution to federal grantor agencies. The Office of the Legislative Auditor issues a statewide biennial Single Audit Report which complies with the reporting requirements listed above. The Single Audit Report for the two fiscal years ended June 30, 1991 has been issued. Copies of the Single Audit Report can be obtained by contacting:

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Helena, MT 59620

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STATE OF MONTANA
Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

September 1992

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLET
Financial-Compliance Audit

JIM PELLEGRINI
Performance Audit

The Legislative Audit Committee
of the Montana State Legislature:

This is our report on the financial audit of the Commissioner of Higher Education's Guaranteed Student Loan Program (GSLP) for the fiscal year ended June 30, 1992. A separate Performance Audit of the GSLP was issued in June 1992.

The Montana Guaranteed Student Loan Program was authorized by the Montana Legislature in 1979 and established July 1, 1980. The GSLP allows eligible students to receive loans from lending institutions to pay for post-secondary education. The federal government guarantees the loans made by lending institutions and makes administrative cost reimbursements to the GSLP.

The Guaranteed Student Loan Program initially contracted with United Student Aid Funds, Inc. to process and service loans. In 1988, the Montana GSLP began assuming the administrative duties associated with the loan guarantee process. During 1990 the GSLP assumed complete administration but continues to contract with United Student Aid Funds, Inc. for computer support services.

We thank the Commissioner of Higher Education and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "Scott A. Seacat".
Scott A. Seacat
Legislative Auditor

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Office of the Legislative Auditor

Financial Audit

For the Fiscal Year Ended June 30, 1992

Guaranteed Student Loan Program

Commissioner of Higher Education

Members of the audit staff involved in this audit were Pearl M. Allen and Paul J. O'Loughlin.

Table of Contents

Independent Auditor's Report & Program Financial Statements	Independent Auditor's Report	1
	Balance Sheet, Special Revenue Fund June 30, 1992	2
	Statement of Revenues, Expenditures and Changes in Fund Balance, Budget and Actual, Special Revenue Fund for the Fiscal Year Ended June 30, 1992	3
	Notes to the Financial Statements	4
Program Response	Guaranteed Student Loan Program	12

Independent Auditor's Report & Program Financial Statements

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122



LEGISLATIVE AUDITOR:
SCOTT A. SEACAT

LEGAL COUNSEL:
JOHN W. NORTHEY

DEPUTY LEGISLATIVE AUDITORS:

MARY BRYSON
Operations and EDP Audit

JAMES GILLET
Financial Compliance Audit

JIM PELLEGRINI
Performance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the Balance Sheet of the Commissioner of Higher Education's Guaranteed Student Loan Program - Special Revenue Fund of the state of Montana as of June 30, 1992, and the related Statement of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual for the fiscal year then ended. These financial statements are the responsibility of the Program's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Guaranteed Student Loan Program - Special Revenue Fund and are not intended to present fairly the financial position and results of operations of the state of Montana in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Guaranteed Student Loan Program of the state of Montana as of June 30, 1992, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "James Gillett".

James Gillett, CPA
Deputy Legislative Auditor

August 27, 1992

COMMISSIONER OF HIGHER EDUCATION
GUARANTEED STUDENT LOAN PROGRAM
SPECIAL REVENUE FUND
BALANCE SHEET
JUNE 30, 1992

ASSETS

Cash in Treasury	\$ 135,937
Due From Banks (note 2)	4,098
Prepaid Expense	3,296
Accounts Receivable	44,022
Due From Federal Government (note 3)	1,523,941
Investments (note 4)	4,590,300

TOTAL ASSETS	\$6,301,594
	=====

LIABILITIES AND FUND BALANCES

Liabilities:

Accounts Payable	\$ 71,925
Due to Federal Government (note 5)	353,657
Deferred Revenue (note 6)	4,477,146

TOTAL LIABILITIES	4,902,728

Fund Balances:

Restricted (note 7)	71,400
Unrestricted	1,327,466

TOTAL FUND BALANCE	1,398,866

TOTAL LIABILITIES AND FUND BALANCES	\$6,301,594
	=====

The accompanying notes are an integral part of this financial statement.

COMMISSIONER OF HIGHER EDUCATION
 GUARANTEED STUDENT LOAN PROGRAM
 SPECIAL REVENUE FUND
 STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
 BUDGET AND ACTUAL
 FOR THE FISCAL YEAR ENDED JUNE 30, 1992

	Budget	Actual	Variance Favorable (Unfavorable)
	-----	-----	-----
REVENUE:			
Guarantee Fee Revenue (note 6)	\$1,095,194	\$1,073,504	\$(21,690)
Administrative Cost Allowance (note 8)	603,184	564,695	(38,489)
Investment Earnings	244,127	191,041	(53,086)
Collection Cost Retained (note 9)	620,733	561,363	(59,370)
Supplemental Preclaims (note 10)	150,000	170,150	20,150
Miscellaneous Revenue	25,000	41,992	16,992
	-----	-----	-----
TOTAL REVENUES	2,738,238	2,602,745	(135,493)
 EXPENDITURES:			
Administrative Costs	2,277,304	2,159,078	118,226
Equipment and Intangible Assets	135,000	125,607	9,393
	-----	-----	-----
TOTAL EXPENDITURES	2,412,304	2,284,685	127,619
 Excess Revenues Over/ (Under) Expenditures	325,934	318,060	(7,874)
 Prior Year Adjustments (note 14)	0	(467)	(467)
 Fund Balance - 07/01/91	1,081,273	1,081,273	0
	-----	-----	-----
Fund Balance - 06/30/92	\$1,407,207	\$1,398,866	\$ (8,341)
	=====	=====	=====

The accompanying notes are an integral part of this financial statement.

COMMISSIONER OF HIGHER EDUCATION
GUARANTEED STUDENT LOAN PROGRAM
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 1992

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of Program

The State of Montana Guaranteed Student Loan (GSL) Program is located in the Office of the Commissioner of Higher Education. As a Special Revenue Fund, it accounts for the proceeds of revenue sources that are legally restricted to expenditures for specified purposes. The program was established by the Office of the Commissioner of Higher Education in fiscal year 1981 to coordinate and administer the federally insured student loans issued by various lending institutions within the State of Montana. Montana's GSL Program operates in compliance with agreements with the U.S. Department of Education, pursuant to Section 428 of the Higher Education Act of 1965.

B. Basis of Accounting

The financial statements were prepared using the modified accrual basis of accounting. Under the modified accrual basis of accounting, expenditures are recorded on the basis of valid obligations. Revenues are recorded when received in cash unless susceptible to accrual.

Revenues are susceptible to accrual if they are measurable and available to finance expenditures of the fiscal period or are not received at the normal time of receipt. Revenues are deferred if material and are received before the normal time of receipt or if received for a particular activity and the expense for that activity has not been incurred prior to fiscal year end.

2. DUE FROM BANKS

The Guaranteed Student Loan Program operates an escrow disbursement service for approximately 39 lending institutions participating in the student loan program. The banks are assessed a fee for this service. Weekly, these lenders wire loan proceeds, scheduled to be disbursed the following week, to GSL. GSL prepares State of Montana warrants to disburse the loan proceeds to borrowers.

As of June 30, 1992 GSL had distributed \$4,098 which was not received until July 1992. Therefore, this amount was adjusted to reflect a receivable, Due From Banks.

3. DUE FROM FEDERAL GOVERNMENT

The Guaranteed Student Loan Program pays individual lending institutions for any loans that have been defaulted or are unpaid due to the death, permanent disability, or bankruptcy of the borrower. The GSL program then seeks reimbursement from the Department of Education (D.E.) for payments made to lenders for the death, permanent disability, bankruptcy, and default claims. The extent of this outstanding reinsurance activity is shown below:

Reinsurance Claims Due From D.E.	\$1,367,028
Plus Administrative Cost Allowance-3rd and 4th quarters FY92 (note 8)	156,913

Total Due from Federal Government	\$1,523,941
	=====

Reinsurance claims due from the Department of Education include \$542,640 in bankruptcy claims which have been purchased from lending institutions but are not eligible for federal reinsurance until the accounts have been dismissed or discharged under bankruptcy proceedings.

4. INVESTMENTS

Investments are units purchased in the State of Montana's Short Term Investment Pool (STIP) and are reflected at cost which equals market. At June 30, 1992, GSL owned 45,903 units valued at \$100 per unit for a total of \$4,590,300 (including accrued interest). STIP securities include Banker's Acceptances, Commercial Paper, Corporate Obligations, Montana Certificates of Deposit, Government Securities, and Repurchase Agreements. At June 30, 1992, most securities (approximately 98.8 percent) were held by the state or its agent in the state's name. The remaining portion (approximately 1.2 percent) were loaned under a security lending agreement with the state's agent.

5. DUE TO FEDERAL GOVERNMENT

GSL seeks collection of loans that have been defaulted. Since the GSL program previously received payment for the defaulted loans from the Department of Education, the amount of the new loan recovery is owed back to the Department of Education. The extent of outstanding claims activity is shown below:

Claims due to D.E.	\$314,429
Reinsurance-3rd and 4th quarters FY92 (note 11)	39,228

Total Due to Federal Government	\$353,657
	=====

6. GUARANTEE FEE REVENUE

The Guaranteed Student Loan Program collects guarantee fees from student borrowers at the time loans are disbursed by the lending institutions. Guarantee fees (3 percent of loans disbursed) are deferred and recognized over an eight year period which approximates the average life of student loans outstanding. Deferred revenue at June 30, 1992 is \$4,477,146.

Earned Guaranteed Fee Revenue for fiscal year 1992 is made up of one-eighth of the annual guarantee fees received as follows:

Fiscal Year	One-eighth of fees
1985	\$ 88,707
1986	99,928
1987	86,646
1988	111,856
1989	135,386
1990	166,654
1991	181,017
1992	203,310

	\$1,073,504
	=====

7. RESTRICTED FUND BALANCE

This fund balance accounts for all interest earnings on the advance of \$734,173 which was received from the U.S. Department of Education during GSL's first six years of operations in order to assist the program in its start-up stages. Although the advance has been repaid, program regulations require that cumulative interest earnings on the advance be maintained for non-reinsured claim payments. Through June 30, 1992, GSL paid \$200,762 in claims.

8. ADMINISTRATIVE COST ALLOWANCE

The GSL Program is reimbursed by the U.S. Department of Education for a portion of its administrative costs. The Administrative Cost Allowance revenue is \$564,695 for the fiscal year ended June 30, 1992, including the third and fourth quarter accruals of \$156,913. This allowance is dependent upon federal appropriation. It represents 1 percent of the loans guaranteed for the fiscal year.

9. COLLECTION COST RETAINED

When the Guaranteed Student Loan Program collects all or a portion of a defaulted loan, the Program is allowed to retain 30 percent of the collected amount as a collection fee. This amount (\$561,363 in fiscal year 1992) was recorded as collection revenue. Expenditures of \$387,158, related to the collection of defaulted loans, are paid for with the retained collection cost revenues. The remaining

70 percent of funds collected on defaulted loans is forwarded to the U.S. Department of Education.

Prior to fiscal year 1992, the GSL Program reported collection costs retained net of collection cost expense.

10. SUPPLEMENTAL PRECLAIMS ASSISTANCE

The Montana GSL Program provides supplemental preclaims assistance to lenders holding delinquent student loan notes that are between 120 and 270 days past due. The GSL staff attempts to contact delinquent borrowers in order to advise them of the options available to them for bringing their delinquent accounts current. After a borrower has been satisfactorily assisted in bringing his/her account current, the U.S. Department of Education reimburses GSL for its efforts. Reimbursements for supplemental preclaims assistance for the 1992 fiscal year is \$170,150.

11. REINSURANCE FEE

The Montana Guaranteed Student Loan Program pays the U.S. Department of Education a reinsurance fee of .25 percent of the total loans guaranteed during the year. The reinsurance fee paid during fiscal year 1992 was \$141,079.

The reinsurance fee is assessed based on the guarantee agency's rate of annual defaults. The amount of reinsurance fees payable to the Department of Education is dependent upon the year-to-date default purchases by the agency divided by the original amount of guaranteed loans in repayment status at the beginning of the year. Montana's annual default rate for federal fiscal year 1991 was 3.66 percent. (See note 12).

12. CONTINGENCIES

The outstanding principal balance of loans guaranteed by the Montana Guaranteed Student Loan Program through June 30, 1992 is \$296,841,885, excluding claims that have been previously purchased by the agency. The federal government fully reinsures loans guaranteed by GSL until the agency's annual default rate exceeds 5 percent. In the event of extreme future adverse loss experience, GSL could be liable for up to 20 percent of the outstanding balance of loans in repayment status.

Montana's GSL Program has entered into agreements with the U.S. Department of Education, dated June 13, 1980, for reinsurance and supplemental reinsurance of loans, in accordance with Section 428 of the Higher Education Act of 1965. These agreements allow for 100 percent reimbursement by the Department of Education for claims due to deaths, disabilities, or bankruptcies. Claims due to defaulted loans may be reimbursed by the Department of Education for up to 100 percent. The percent of reimbursement on defaulted loans

payable to the agency and the reinsurance fee payable to the Department of Education is dependent upon GSL's annual default rate according to the following schedule:

RATE OF ANNUAL DEFAULTS	FEDERAL REINSURANCE	FEDERAL REINSURANCE FEE
0 to 5%	100%	.25%
More than 5% but less than or equal to 9%	100% of claims through 5%; 90% of claims over 5% but less than or equal to 9%	.50%
Over 9%	100% of claims through 5%; 90% of claims over 5% but less than or equal to 9%; 80% of claims over 9%.	.50%

13. COMMITMENTS

On December 1, 1991, the Montana Guaranteed Student Loan Program entered into a Guarantee Reserve Agreement with the Montana Higher Education Student Assistance Corporation (MHESAC), a nonprofit corporation. Under this agreement, GSL is required, among other covenants, to maintain an amount in the guaranteed reserve fund equal to at least 1.5 percent of the unpaid principal balance of all outstanding loans guaranteed by GSL. The purpose of this agreement is to ensure that GSL will have sufficient cash available to carry out its guarantee function and to cover its reasonably expected obligations on guaranteed defaulted student loans. The Guarantee Reserve Agreement ensures that a secondary financial market of guaranteed student loans exists in Montana, thereby encouraging lending institutions to participate in the program.

The Guarantee Reserve Agreement also requires that GSL undergo annual financial audits by a firm of independent certified public accountants acceptable to the Trustee, the Letter of Credit Issuer, and MHESAC.

14. PRIOR YEAR ADJUSTMENTS

The prior year adjustments of \$467 consists of payments for miscellaneous services incurred in fiscal year 1991 but not billed until fiscal year 1992.

15. FIXED ASSETS

The Guaranteed Student Loan Program is accounted for on the State-wide Budgeting and Accounting System (SBAS) as a special revenue

fund. The fixed assets of GSL, which total \$404,254 as of June 30, 1992, are included in the General Fixed Assets Account Group within the accounting entities of the Office of the Commissioner of Higher Education.

16. COMPENSATED ABSENCES LIABILITY

The liability for compensated absences for the Guaranteed Student Loan Program, which total \$64,325 as of June 30, 1992, is included in the Long Term Debt Account Group within the accounting entities of the Office of the Commissioner of Higher Education.

17. EMPLOYEES' RETIREMENT SYSTEM

The Guaranteed Student Loan Program employees are covered by the Public Employees' Retirement System (PERS), the Teachers' Retirement System (TRS), or the University System Optional Retirement Plan, TIAA-CREF. Professional employees with contracts under the authority of the Board of Regents may choose either the Montana Teachers' Retirement System (TRS) or the Optional Retirement Program (ORP), which is available through the Teachers' Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF). The classified staff is provided a retirement program through the Montana Public Employees Retirement System (PERS).

DEFINED BENEFIT PLANS

Public Employees Retirement System (PERS)

Established in 1945 and governed by Title 19, Chapter 3, MCA, Public Employees' Retirement System participants are eligible to retire at age 60 with at least five years of service, at age 65 regardless of length of service or at 30 years of service regardless of age. A reduced retirement benefit may be taken with 25 years of service or at age 50 with a minimum of five years of service. Effective January 1, 1989 monthly retirement benefits are calculated by taking 1/56 times the years of service times the final average salary. Vesting occurs once membership service totals 5 years. Under PERS, the state contributed 6.417 percent of an employee's gross wages. The employee contributed 6.417 percent of his gross wages.

Teachers' Retirement System (TRS)

The Teachers' Retirement System is a mandatory system established in 1937 and governed by Title 19, Chapter 4, MCA. Teachers' Retirement System participants are eligible to retire with a minimum 25 years of membership service or five years of creditable service at age 60. A retirement benefit is 1/60 times the years of service times average final compensation. An employee is vested in TRS following completion of five years of creditable service. Vested employees may retire at or after age 50 and receive a reduced retirement benefit.

Under TRS, the state contributes 7.459 percent of an employee's gross wages. The employee contributes 7.044 percent of his gross wages.

DEFINED CONTRIBUTION PLAN

The Optional Retirement Program (ORP), a defined contribution plan, established under the authority of Title 19, Chapter 21, MCA, provides benefits at retirement which are dependent upon the amount of contributions, investment gains and losses, employee's life expectancy, and the selected contract option. Under TIAA-CREF, the state contributes 2.956 percent to TIAA and 4.503 percent to TRS. The employee contributes 7.044 percent of his gross wages to TIAA.

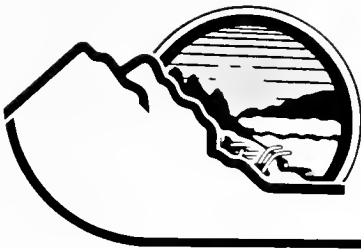
The State's policy is to fund accrued pension costs although unfunded liabilities exist. Based on their most recent actuarial valuation reports, both the PERS and the TRS were actuarially sound.

RETIREMENT PLAN INFORMATION FOR GSL PROGRAM EMPLOYEES FOR THE YEAR ENDED JUNE 30, 1992

	PERS	TRS	ORP (TIAA-CREF)
Covered Payroll	\$623,331	\$89,214	\$ 8,545
Total Payroll	737,537	737,537	737,537
Employer Contributions	\$39,999	\$6,654	\$253
Percent of Covered Payroll	6.417%	7.459%	2.956%
Employee Contribution	\$39,999	\$6,284	\$602
Percent of Covered Payroll	6.417%	7.044%	7.044%

For ORP participants, a total of \$255 or 4.503 percent was contributed to TRS from employer contributions to amortize past service unfunded liability in accordance with Title 19, Chapter 21, MCA.

Program Response



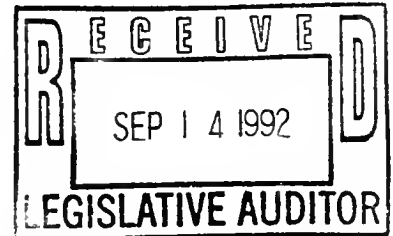
MONTANA GUARANTEED STUDENT LOAN PROGRAM

2500 Broadway • Helena, Montana 59620-3103

(406) 444-6594 FAX (406) 444-0684

Customer Assistance (800) 537-7508

September 11, 1992



Scott A. Seacat
Legislative Auditor
Capitol Station
Helena, MT 59620

Dear Scott:

This letter confirms completion of the Guaranteed Student Loan Program's audit performed by your staff. It is my understanding there were no recommendations.

I want to take this opportunity to thank you and your staff for the fine spirit of cooperation.

Please be assured that the student loan program staff will continue to evaluate and improve our services to lenders and educational institutions. Their confidence is of utmost importance if students are to maintain access to the private capital of the lending community.

Sincerely,

Bill Lannan, Director
Guaranteed Student Loan Program

